Employee Benefits Report

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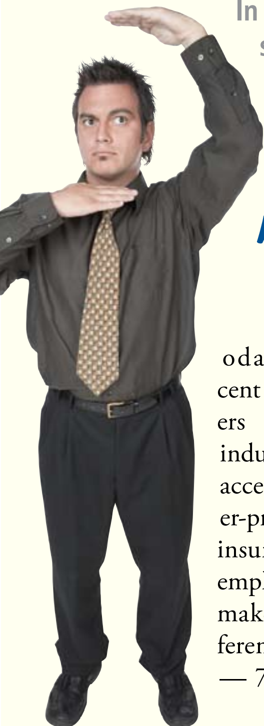
How Do Your Life Benefits Measure Up?

In December 2010, the U.S. Bureau of Labor Statistics released "Program Perspectives," a report on life and disability insurance benefits. Using information gathered in the National Compensation Survey, the report provides an overview of what employers offer in terms of life and disability benefits and participation rates. In this article, we'll focus on what the report says about life insurance benefits today in the U.S.



Today, 59 percent of all workers in private industry have access to employer-provided life insurance. An employee's status makes a big difference, though — 73 percent of full-time workers have access to life benefits, while only 15 percent of part-timers do.

Employees appreciate the value of group life insurance, as demonstrated by high take-up rates. Seventy-three percent of full-time private industry workers have access to life benefits, and a full 71 percent participate. Only 23 percent of part-timers have access, but 22 percent participate. In addition, employees keep their life benefits. The American Council of Life Insurers reports that only 6.6 percent of group life policies in 2009 had voluntary lapses.

What Employers Offer

The report shows that employers are quite generous with life benefits. Only 5 percent of private industry employees and 11 percent of state and local government employees participating in life insurance plans had to pay a portion of the cost.

Fifty-eight percent of private industry participants had basic coverage equal to a fixed multiple

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This Just In…

U.S. Labor Secretary Hilda Solis has consistently stated that all of the work of the Department of Labor is focused on achieving "good jobs for everyone." In testimony before Congress in April, Thomas M. Markey, deputy administrator for program operations at the Wage and Hour Division, U.S. Department of Labor, described the Labor Department's vision of a "good job" as one that:

- increases workers' incomes and narrows wage and income inequality;
- assures workers are paid their wages and overtime;
- assures workers are in safe and healthy, fair and diverse workplaces;
- provides workplace flexibility for family and personal care-giving;
- improves health benefits and retirement security for all workers; and
- assures workers have a voice in the workplace.

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of annual earnings, while 36 percent had a flat dollar amount of coverage. For those workers with coverage of a fixed multiple of annual earnings, 61 percent had one times earnings, and 22 percent had two times earnings. Flat dollar amounts varied widely, but the median amount was $15,000 for private industry workers and $20,000 for state and local government workers.

Features of Group Life Insurance

When an employer buys group life insurance, it contracts with the insurer to cover all the group's members. The employer usually receives the actual policy, while participating employees receive certificates of coverage.

Most group life policies are term insurance, rather than whole life or permanent insurance. Term life insurance provides a death benefit if the insured dies while the policy is in force, but typically no benefit if he/she lives past that time. It builds no cash value and doesn't have an investment component.

Some group life insurance plans have features that provide benefits beyond simple term life coverage, however. Some allow employees to keep their coverage after retirement by paying premiums directly to the insurer. Others allow plan members to convert their coverage to an individual term policy, up to a specified dollar amount, without undergoing underwriting. This feature can help individuals whose health might otherwise prevent them from buying life insurance to keep at least a minimum amount of coverage.

Some group life insurance policies offer benefits designed to extend coverage to other family members. If a policy offers survivor benefits, it will pay a monthly sum to the spouse of a group member who dies before retirement. Some policies with survivor benefits will pay contingent benefits to dependent children if the spouse dies as well.

Tax Advantages

When an employer buys group life coverage for its employees, both the employer and employee enjoy tax advantages. IRC Section 79 excludes from an employee's taxable income the premiums for the first $50,000 of group-term life insurance coverage provided under a policy carried directly or indirectly by an employer. The employer can also deduct these premiums as a business expense.

A taxable fringe benefit arises if coverage exceeds $50,000. The whole premium is not taxable, just any premiums imputed to coverage over $50,000. When an employer pays for group term life insurance on an employee's spouse or dependent, the cost is not taxable to the employee if the face amount does not exceed $2,000. If spouse or dependent coverage exceeds $2,000, the entire premium amount becomes taxable income, not just the amount that exceeds $2,000. There is an exception for S-corporation shareholders. You cannot treat a 2 percent shareholder of an S-corporation as an employee for purposes of the exclusion, so you must include the cost of all group-term life coverage you provide in his or her wages.

There is also an exception for group-term life insurance plans that favor key employees. If the plan favors key employees, you must include the entire cost of the insurance in these employees' wages. See IRS Publication 15-B for more discussion on these exceptions.

For more information on the advantages of life insurance benefits, or to ensure your organization's benefits are competitive, please contact us. ■

Correction: In our April issue, the subhead for the article "What Plan Sponsors Need to Know About Target-Date Funds in 401(k)s" stated "… when a plan uses target-date funds as the default investment, plan fiduciaries receive 'safe harbor' protection and plans gain exemption from annual nondiscrimination testing requirements and 'top-heavy' rules." This should have read: "when a plan uses target-date funds as the default investment along with a qualified automatic contribution arrangement (QACA)… " We regret the error.

Markey stated: "To achieve this goal, the Department is using every tool in its toolbox, including increased enforcement actions, increased education and outreach, and targeted regulatory actions. These unifying themes seek to foster a new calculus that strengthens protections for workers and results in significantly increased compliance."

We can help ensure your employees have "good jobs" through strong benefit programs and compliance with labor laws and regulations. Please contact us for more information.

Cutting Group Health Costs

Employers' group healthcare costs continue to grow faster than the general inflation rate — up an average of 7 percent over 2010 costs, to $11,176 per employee. Employees' share of healthcare costs are going up as well — to an average of $2,660 per employee. Employers are taking a variety of strategies to contain these costs. A few for you to consider follow.

1. **Focus on improving employee health.** The Thomson Reuters Workforce Wellness Index found that six behavioral risk factors — body mass index, blood pressure, cholesterol, blood glucose, tobacco use and alcohol use — accounted for $670 in direct healthcare costs per employee per year. Of this, $400 was attributed to body mass index and $150 to elevated blood sugar. Focusing your wellness and prevention efforts on these controllable factors can improve health and save money.
2. **Give your wellness program some teeth.** The 16th Annual Towers Watson/National Business Group on Health Employer Survey found that one-third of employers plan to reward or penalize employees for achieving weight and cholesterol targets in 2012, up from 7 percent in 2011.
3. **Reduce benefits.** In the Towers Watson/NBGH survey, 91 percent of employers said they planned to cut back on employee healthcare coverage. If you do cut, cut wisely — increasing out-of-pocket costs for prescription drugs or preventive care can backfire by discouraging employees from buying needed drugs or make them wait too long for preventive care.
4. **Increase employee contributions for spouse or family coverage.** According to the Bureau of Labor Statistics' National Compensation Survey, private industry employees paid an average of 20 percent of premiums for single-only coverage and only 30 percent for family coverage in 2010. During 2010, single-only coverage cost an average of $5,049 and family coverage cost an average of $13,770 per year, according to the Kaiser Family Foundation. The Towers Watson/NBGH survey found that 89 percent of employers surveyed are cutting back on spouse and dependent benefit costs: 68 percent will increase contributions for dependents, with 19 percent adding per-dependent contributions, and 35 percent using or planning to use spousal waivers or surcharges.
5. **Rework retiree coverage.** According to the Towers Watson/NBGH survey, more than half of employers surveyed either plan to stop sponsoring retiree medical coverage or plan to convert a subsidy to a retiree health account. Nearly one-quarter (23

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percent) plan to eliminate employer-sponsored drug coverage for Medicare-eligible retirees.

6 **Give healthcare providers incentives for quality care.** Health plans can encourage better quality care by offering providers incentives for using evidence-based treatments and emerging technologies.

7 **Coordinate care.** Individuals with multiple health conditions often require care from several specialists and many prescription drugs. Duplication and possibly dangerous interactions can result if doctors fail to coordinate treatments. One study estimated duplications and follow-up care cost $25 billion to $50 billion a year. By assigning these individuals a "medical home," a primary care provider who oversees all treatment, you can reduce duplicative healthcare expenses and minimize the chance of dangerous interactions.

8 **Steer employees to high-performance networks or "centers of excellence."** Healthcare providers are not all created equal — some have measurably better patient outcomes than others.

9 **Give employees the tools to make educated healthcare decisions.** Ask your health plan provider to provide health outcome and cost information for network providers. Encourage employees to use formulary or generic drugs where appropriate.

10 **Change your plan type.** Account-based health plans (ABHPs), such as high deductible health plans (HDHPs) paired with health savings accounts (HSAs) cost an average of $730 less than HMOs for employee-only coverage and $2,118 less for family coverage. Single coverage under a preferred provider organization (PPO) or point of service (POS) plan costs about $200 more than under an HMO, while family coverage under a PPO or POS costs the most, at $750 more than under an HMO. According to the Towers Watson/NBGH survey, the number of employers offering ABHPs jumped from 2 percent in 2002 to 53 percent in 2011. Another 13 percent of respondents plan to offer ABHPs in 2012.

For more ideas on controlling employee health costs, please contact us. ■

Time to Reconsider Cash Balance Plans

In the 1990s and early 2000s, many employers looking to control their pension liabilities converted traditional defined benefit pension plans to cash balance plans. Some older employees affected by the change sued, alleging age discrimination. Most suits resolved in favor of employers, and the Pension Protection Act of 2006 affirmed the legitimacy of cash balance plans. Other, more recent developments also make cash balance plans worth another look.

Although the Pension Protection Act labeled cash balance plans legal, implementing regulations left some aspects of plan management unclear. In late 2010, the IRS issued new regulations that clarify requirements for an age discrimination safe harbor and define the "market rate" of interest that plan sponsors must apply to cash balance plan participants' account balances.

What Exactly Are Cash Balance Plans?

Federal law recognizes two categories of pension plans: defined benefit (DB) plans and defined contribution (DC) plans. Although legally defined as DB plans, cash balance plans combine features of DB and DC plans. Sometimes cash balance and other account-based defined benefit plans are called "hybrid plans."

With a defined benefit plan, the employer promises an employee a specified future benefit, traditionally an annuity beginning at retirement. The annuity amount usually depends on a formula that factors in the employee's years of employment and the average salary of the employee's highest salaried years.

With a defined contribution plan, each employee has an account,

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as with a 401(k) plan. Employees contribute a portion of their pretax salary. In a traditional 401(k) plan, employers have the option of making contributions on behalf of all participants, making matching contributions based on employees' elective deferrals, or both. Employers are not required to contribute, however.

In a DC plan, the employee bears the investment risk—the actual amount of retirement benefits he or she receives will depend on the amount of contributions as well as investment gains or losses on the account. DC plans also differ from DB plans in that the Pension Benefit Guaranty Corporation does not insure benefits.

A cash balance plan combines features of DC and DB plans. In a typical cash balance plan, each year the employer credits a participant's account with a pay credit (such as 5 percent of compensation) and interest (either a fixed rate or a variable rate linked to an index, such as the one-year Treasury bill rate). Changes in the value of the plan's investments do not directly affect the benefit amounts promised to participants.

When a participant becomes entitled to receive benefits under a cash balance plan, the account balance determines the benefits he or she receives. A participant who had an account balance of $100,000 at retirement, for example, could take a lump sum of $100,000 or convert that amount into an annuity.

In addition to generally permitting participants to take their benefits as lump sum benefits at retirement, cash balance plans often permit vested participants to choose (with consent from their spouses) to receive their accrued benefits in lump sums if they terminate employment prior to retirement age. Traditional defined benefit pension plans do not offer this feature as frequently.

Advantages of Cash Balance Plans

Cash balance plans benefit employees at both ends of the pay spectrum. Cash balance plans typically do not require employees to contribute salary deferral dollars to their accounts in order to receive an employer contribution, making them more attractive to lower-paid workers who might not participate in a 401(k).

They also appeal to higher-paid workers, since they have much higher contribution limits. Defined benefit 415 plans have a maximum contribution limit of $195,000 for 2011 — compared to a maximum contribution of $49,000 for defined contribution plans.

Employees find these plans easier to understand than defined benefit plans, which generally require an actuary to calculate benefits. They can also predict more accurately what the value of their benefits will be at retirement, something they cannot do with a defined contribution plan.

A recent Vanguard study of defined benefit plan sponsors found that 13 percent planned to convert their plan to another type, such as a cash balance plan or other hybrid plan.

Like defined contribution plans, cash balance plans also offer portability. When employees leave their job, they can take the cash in their accounts or roll it over, rather than waiting for retirement.

For employers, cash balance plans provide the advantage of making pension liabilities predictable. They are easier to administer than other defined benefit plans and have fewer problems with nondiscrimination testing than defined contribution plans, because they don't depend on workers' salary deferral contributions.

Cash balance plans hold special appeal for small businesses with self-employed owners and healthy cash flow and profits. Owners of these businesses can shelter a larger portion of their salary than with a 401(k) and provide valuable retirement benefits to workers as well. For more information on cash balance plans, please contact us.

Defined Benefit, Defined Contribution, and Cash Balance Plans: Key Differences

There are four major differences between typical cash balance plans and 401(k) plans.

- **Participation.** Cash balance plans generally do not depend on workers contributing to the plan; however, participation in a 401(k) plan does depend, in whole or in part, on an employee choosing to contribute.
- **Investment Risks.** The investments of cash balance plans are managed by the employer or an investment manager appointed by the employer. The employer bears the risks and rewards of the investments. Increases and decreases in the value of the plan's investments do not directly affect the benefit amounts promised to participants. By contrast, 401(k) plans often permit participants to direct their own investments within certain categories. Under 401(k) plans, participants bear the risks and rewards of investment choices.
- **Life Annuities.** Unlike many 401(k) plans, cash balance plans must allow employees to receive benefits in the form of lifetime annuities.
- **Federal Guarantee.** Since they are defined benefit plans, benefits promised under cash balance plans are usually insured by the Pension Benefit Guaranty Corporation (PBGC). Defined contribution plans, including 401(k) plans, are not insured by the PBGC. ■

Feature	DB	DC	Cash Balance
Funded by	Employer and employee	Employee (plus optional employer contribution)	Employer and employee
Investment risk responsibility	Employer	Employee	Employer (until employee leaves job)
Rate of return guaranteed?	Yes, for employee contributions	No	Yes, for employee contributions
Benefit accrual	"Back loaded," most accumulation occurs at end of career	Front loaded: accumulation at start of career	Even

Source: ***What Are Hybrid Retirement Plans: A Quick Reference Guide,*** Center for State & Local Government Excellence

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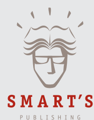

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